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The Financial Crisis: A Reason to Improve Shareholder Protection in the EU?

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Abstract: The global financial crisis of 2008 has stimulated the debate on corporate governance and shareholder protection. The intuitive reason for the topicality of shareholder protection is that insolvencies mainly harm shareholders as the companies' residual claimants. In addition, ideally, shareholder empowerment may ensure better monitoring of management and therefore better-run companies preventing corporate failures and benefiting the economy as a whole. Yet, it is not self-evident that shareholder participation has such a positive effect. This paper critically examines the discussion about the relationship between the financial crisis, shareholder protection and law reform. We also develop a central position: while there may be a need to improve shareholder protection, we do not take the view that any increase in shareholder rights is the right way forward; rather, such reforms should aim to encourage shareholder engagement by responsible long-term investors.

Keywords: shareholder protection, financial crisis, EU company law, long-term investors, shareholder engagement, institutional investors, shareholder activism

JEL Codes: G23, G34, G38, K22, M14, O16

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INTRODUCTION

Before the 2008 financial crisis, the world economy seemed to be relatively founded on a secure platform, and even at the beginning of the crisis few anticipated its destructive effects.¹ Now, however, policy debates have been mushrooming, for instance, on matters of bank bail-outs, international financial regulation, economic stimulus and austerity, but also corporate governance and shareholder protection.² Regulators are struggling to place business operations on a more secure basis. Yet, the question remains whether improving corporate governance and shareholder protection are the right answer. In the context of the recent financial crisis and shareholder protection, views are diverse in regard to whether to blame or exonerate corporate governance.³

Our examination reveals the issues to be more complex than hitherto understood. The intuitive reason for the topicality of shareholder protection is that increases in insolvencies harm shareholders as the companies' residual claimants. In addition, ideally, shareholder empowerment may ensure better monitoring of management and therefore better-run companies benefitting the economy as a whole. Yet, it is not self-evident that the crisis actually calls for improvements of shareholder protection. For instance, one can make the point that shareholders of public companies are often only interested in

¹ See, e.g., B.R. Cheffins, 'Did Corporate Governance "Fail" During the 2008 Stock Market Meltdown? The Case of the S&P 500' (2009) 65 *Business Lawyer* 1, at 4 ('Too few regulators, stock market analysts, and journalists ... foresaw the havoc that would follow if and when it burst.').

² For the general discussion on regulation and the financial crisis see, e.g., S. Konzermann and M. Fovargue-Davies (eds.), *Banking Systems in the Crisis: The Faces of Liberal Capitalism* (2013); E. Avgouleas, *Governance of Global Financial Markets* (2012); J. Gray and O. Akseli (eds.), *Financial Regulation in Crisis?: The Role of Law and the Failure of Northern Rock* (2011).

³ Similar J. Armour and W.-G. Ringe, 'European company law 1999-2010: renaissance and crisis' (2011) 48 *Common Market Law Review* 125, at 169 (no consensus whether existing corporate governance is deficient or simply poorly implemented).

short-term benefits, and that such short-termism was precisely what contributed to the financial crisis.⁴

Specifically, we are interested in the relationship between shareholder protection and the financial crisis in the context of EU corporate governance. Taking the current law as a starting point it is difficult to say that the EU has ‘failed’ to align corporate governance with shareholder protection. On the one hand, the EU did address shareholder protection in the past, sometimes directly – namely in the Shareholder Rights Directive⁵ – sometimes indirectly in other directives and regulations.⁶ On the other hand, the question is whether these rules have really provided shareholders with a strong voice in the corporate governance of public companies.⁷ Moreover, many topics of shareholder protection have not been harmonised, for example, the enforcement of directors’ duties or the rights of minority shareholders. Thus, assuming the need for better shareholder protection, more harmonisation could be needed.

The paper proceeds as follows. The first section explores the differing views on whether the financial crisis shows failures of corporate governance – or whether its main reasons lie elsewhere. The second one critically discusses the claims that, after the crisis, shareholder empowerment should be strengthened. Third, we look at issues of shareholder participation in corporate governance, and examine investor culture in light of the financial crisis. This forms the basis for our central position, namely, that law reforms should aim to encourage shareholder engagement by responsible long-term investors. For this purpose, this section also provides specific suggestions on how such ‘better engagement’ may be achieved. Fourth, assuming there is a need to improve shareholder protection, we discuss the right form and level of legal reform, ranging from self-regulation to national, European and international initiatives. The final section concludes.

THE CRISIS: EVIDENCE OF CORPORATE GOVERNANCE FAILURES?

A number of reasons have been suggested on why the financial crisis occurred.⁸ These views include those who argue that corporate governance failed in the crisis, in particular as regards the protection of shareholders. Others take the view that the 2008 financial crisis was not a verdict on corporate governance. We outline these differing positions before reaching the conclusion that it is difficult to decisively exonerate or blame corporate governance for the 2008 financial crisis.

⁴ For details see the discussion in the following sections.

⁵ Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies.

⁶ Notably through the harmonisation of securities law in terms of disclosure and transparency. See, e.g., Directive 2004/109/EC on the harmonisation of transparency requirements (...). For a useful overview see European Parliament - Committee on Legal Affairs, ‘Rights and obligations of shareholders – National regimes and proposed instruments at EU level for improving legal efficiency’, PE 462.463 (May 2012), pp. 21-36.

⁷ P.E. Masouros, ‘Is the EU Taking Shareholder Rights Seriously?: An Essay on the Importance of Shareholdership in Corporate Europe’ (2010) 7 *European Company Law* 195, at 196.

⁸ See generally, e.g., the literature cited op. cit., n. 2.

Roman Tomasic and Folarin Akinbami⁹ observe that in the run-up to the banking crisis of 2007-2008 boards and regulators in the UK did not adequately protect shareholders. They argue that in the banking sector much decision-making was left to CEOs who undertook excessive risks without restraint from the boards and regulators. Internal regulation within corporations and corporate networks needs to be backed by networked regulation as well as by effective external regulatory mechanism which imposes some sanction for failure. But the problem was that regulators took a ritualistic approach to regulating corporations, and 'government regulators seemed to have the role of providing reassurance to market actors rather than effectively sanctioning them.'¹⁰

Observing the plight of shareholders, Tomasic and Akinbami note that shareholders have traditionally simply voted with their feet and sold their shares, but even that did not seem to affect boards.¹¹ For shareholders to engage with the boards effectively, they argue that companies need to provide more information to shareholders to allow them to act effectively. They observe that under the principle of director primacy, the responsibility to manage and limit risk rests with the boards and CEOs. In that regard, shareholders have much less capacity to influence decision-making, and it does not help that the courts have buttressed this under the so-called business judgment rule to support board primacy. Thus, Tomasic and Akinbami call for boards to spend more time on company matters, and for board members to be required to have greater banking related expertise.¹²

A similar focus on boards has been taken by the UK's Treasury Committee of the House of Commons.¹³ It identified three problems with corporate governance in light of the financial crisis: (a) lack of time many non-executives devote to their role, (b) too many non-executive directors within the banks lack relevant banking or financial experience, and (c) banks drawing upon too narrow a talent pool when appointing non-executive directors to the detriment of diversity of views. With respect to shareholder empowerment, all of this can be read to imply that making shareholders appoint better directors would be an important step in the right direction.

In the literature it has been suggested that the EU should increase shareholder protection in order to restore trust in capital markets.¹⁴ The EU institutions seem to follow this suggestion. The European Commission published a Green Paper in April 2011,¹⁵ and

⁹ R. Tomasic and F. Akinbami, 'Towards a New Corporate Governance After the Global Financial Crisis' (2011) *International Company and Commercial Law Review* 237. See also R. Tomasic and F. Akinbami, 'The Role of Trust in Maintaining the Resilience of Financial Markets' (2011) 11 *Journal of Corporate Law Studies* 369.

¹⁰ *Id.*, p. 242.

¹¹ *Id.*, p. 248.

¹² *Id.*, p. 249.

¹³ Treasury Committee, House of Commons (HC 416), *Banking Crisis: Dealing with the failure of the UK banks* (2009) 10-11.

¹⁴ Masouros, *op. cit.*, n. 6, p. 203.

¹⁵ European Commission, 'Green Paper: The EU corporate governance framework', COM(2011)164 final.

submitted an Action Plan in December 2012.¹⁶ Inter alia, the plan suggests that there may be changes to the Shareholder Rights Directive¹⁷ in the coming years.

But the question on ‘what went wrong’ has also triggered a different response. For example, according to John Coffee, ‘the 2008 financial crisis stands above all as testimony to the error of excessive reliance on broad principles and self-regulation.’¹⁸ He relates this specifically to the regulatory system in the EU and how it applies to US companies. The EU adopted the Financial Conglomerates Directive 2002/87/EC, the main thrust of which was to require regulatory supervision at the parent company level of financial institutions. Yet, major US financial institutions lobbied the Securities and Exchange Commission (SEC) for a system of ‘functional equivalent’ regulation to satisfy the EU Directive. This procedure allowed US banks to generate their own risk models, which the banks quickly turned into a process of self-regulation. It also allowed the banks to opt for a relaxed ‘alternative net capital rule’ instead of the traditional capital adequacy rule that placed a maximum ceiling on debt to equity ratio. What followed, Coffee explains, was a reckless expansion by the US investment banks, characterised by relaxed due diligence standards to compete for the markets, taking on a greater risk in real estate investment with undiversified exposure to a downturn in the market. When the liquidity from risky acquisitions of sub-prime mortgages hit the market, investment banks were hit the hardest, and this had a negative knock-on effect on the rest of the financial institutions in the global market associated with US banks.

As one reads the analysis by Coffee, as to what went wrong, the implication seems to be that it had nothing to do with corporate governance failure. If there is apportioning of blame, it lies with regulation of securities in the financial market. But even then, it is difficult to say that securities regulation failed to protect shareholders, for shareholders were fully supportive and involved in the seemingly irresponsible practices of financial institutions that led to the 2008 financial crisis. For example, in reviewing the histories of failed UK companies, the Kay Review found that many of the bad decisions leading to the failures were supported or even encouraged by a majority of the shareholders.¹⁹ To fully blame securities regulators for what went wrong would be to assign a very paternalistic responsibility to regulators to protect shareholders from themselves.

In a similar vein, Brian Cheffins takes the view that corporate governance did not fail in the 2008 financial crisis.²⁰ He reaches this conclusion by a detailed examination of corporate governance practices in the thirty-seven companies that were removed from

¹⁶ Communication from the Commission, ‘Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies’, COM(2012) 740 final.

¹⁷ Op. cit., n. 5.

¹⁸ J.C. Coffee, ‘What went wrong? An Initial Inquiry into the Causes of the 2008 Financial Crisis’ (2009) 9 *Journal of Corporate Law Studies* 1, at 22.

¹⁹ The Kay Review of UK Equity Markets and Long-Term Decision Making, Final Report (July 2012), para. 1.28. The general findings of this review were endorsed by the Department for Business, Innovation and Skills (BIS), Ensuring Equity Markets Support Long-Term Growth, The Government Response to the Kay Review, November 2012; House of Commons, Business, Innovation and Skills Committee, The Kay Review of UK Equity Markets and Long-Term Decision Making, Third Report of Session 2013–14, HC 603, July 2013.

²⁰ Cheffins, op. cit., n. 1. A similar study of US firms is R.B. Adams, ‘Governance and the Financial Crisis’ (2012) 12 *International Review of Finance* 7.

the iconic S&P 500 index of publicly traded companies during the stock market turmoil of 2008. In these companies, Cheffins found that in various key respects corporate governance operated satisfactorily. Corporate failures that occurred were largely fraud-free; boards of directors generally performed satisfactorily enough to avoid public criticism; and in troubled companies the directors were far from complacent, as they orchestrated CEO turnover at a rate greatly exceeding the norm in publicly traded firms. In conclusion, Cheffins observes that events occurring during 2008 do not provide a convincing case for radical initiatives.²¹ Based on these findings, he also cautions that lawmakers would be unwise to treat the stock market turmoil of 2008 as a justification for sweeping corporate governance reforms.²²

These divergent views demonstrate the difficulties of exonerating or blaming corporate governance for the recent financial crisis. A possible explanation is that the relevant causes are not independent of each other: for example, if one considers the risks of speculative financial instruments, one interpretation may refer just to the existence of these instruments while another one may say that deficiencies in corporate governance allowed managers to make use of them. Moreover, a possible reason for these ambiguities is that considering the relevance of corporate governance as a whole is too abstract. Thus, there may well be lessons to be learnt for more specific topics of company law. It is a question of what lessons and whether that should lead to a stronger empowerment of shareholders, to which examination we turn to next.

SHAREHOLDER EMPOWERMENT: STATUS QUO AND WAY FORWARD

The traditional role of shareholders in corporate governance, mainly reduced to voting on company matters in a general meeting, may explain the difficulty shareholders find in playing an effective role in averting corporate failures. Whereas shareholders may vote in the general meeting on issues that shape the company, the power to manage the company is reserved for the board of directors.²³ If directors manage the company in a manner that causes financial loss, shareholders may be able to file a derivative claim.²⁴ But they may also want to intervene earlier: combining a monitoring and disciplinary role, they could aim to remove incompetent directors from office.

Yet, this is not always straight-forward. In German law, the management board can only be dismissed by the supervisory board in the event of an important reason, which is presumed if the general meeting withdraws its confidence, and dismissal of supervisory board members is only possible by three quarters of the votes cast, unless an important reason is present.²⁵ In the UK, Section 168 of the Companies Act empowers shareholders to appoint and remove directors from office at any time. However, for a director

²¹ Id., p. 61.

²² Id., p. 4.

²³ For a comparative overview see M. Siems, *Convergence in Shareholder Law* (2008) 152-3. Specifically for the UK see *Harold Holdsworth & Co (Wakefield) Ltd v. Caddies* [1955] 1 W.L.R. 352; *Automatic Self-Cleansing Filter Syndicate Co Ltd v. Cuninghame* [1902] 2 Ch. 34; *Percival v Wright* [1902] 2 Ch. 421 (directors do not, in general, owe fiduciary duty to shareholders).

²⁴ Siems, op. cit., n. 23, pp. 212-8 (comparative overview).

²⁵ See §§ 84(3), 103(1),(3) German Companies Act (Aktiengesetz).

with a service contract, even where there has been clear wrongdoing by the director, the company may prefer to pay the director to go quietly, rather than insist on dismissing him without notice.²⁶ A director with a service contract may also be entitled to compensation for dismissal.²⁷ The political necessity to keep the director reasonably well disposed towards the company, if he or she is the only one to be removed and is aware of wrongdoings by other directors, may prove an impediment to his removal.²⁸ In companies with limited number of shareholders, where the company's articles provides for voting arrangements in favour of a director/member being removed,²⁹ removal would be difficult.³⁰ The practical remedy may well lie in shareholders simply selling their shares and investing elsewhere. This inevitably reduces the role of shareholders to that of monitoring market price index for an exit strategy.

In light of the financial crisis, does the answer lie in law reform for greater shareholder empowerment, for instance introducing binding votes on executive remuneration policy, as recently proposed by the European Commission?³¹ William Bratton and Michael Wachter have little sympathy with greater shareholder empowerment as a part of regulatory response to the financial crisis.³² To them, shareholder empowerment would make it much more difficult for a good board of directors to resist pressures to manage to the market. Moreover, incentive-compatible executive compensation and shareholder empowerment are seen as inconsistent goals. They argue that if executive compensation can be fixed by requiring longer holding periods, it is then turned around and unfixed if managers are encouraged to manage the market as a response to shareholder empowerment.³³

Similar views have been expressed by other academics. Alan Dignam argues that shareholder empowerment as a reform mistakenly characterise shareholders as willing and responsible owners when in the recent bank failures it was shareholders' activism that was a significant problem.³⁴ According to Lynn Stout the 'mantra' that directors are obliged to maximise shareholder value leads to 'reckless, sociopathic and socially irresponsible behaviours', which not only harm the corporation and the public but also

²⁶ P.L. Davies and S. Worthington, *Gower and Davies Principles of Modern Company Law* (9th edn., 2012) 415.

²⁷ Section 168(5)(a) CA 2006.

²⁸ J. Lowry and A. Reisberg, *Pettet's Company Law* (3rd edn., 2009) 180.

²⁹ See *Bushell v. Faith* [1970] A.C. 1099.

³⁰ D. Kershaw, *Company Law in Context* (2nd edn., 2012) 227.

³¹ European Commission, op. cit., n. 16, p. 9. This is in line with recent reforms in the UK and the US: see Section 439A CA 2006, inserted by, Enterprise and Regulatory Reform Act 2013, c. 24; Section 951 US Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub.L. 111-203, H.R. 4173). But see also C.M. Bruner, 'Corporate Governance Reform in a Time of Crisis' (2011) 36 *Journal of Corporate Law* 309 (for differences in shareholder orientation between the US and the UK as they relate to recent reforms).

³² W. Bratton and M. Wachter, 'The Case Against Shareholder Empowerment' (2010) 158 *University of Pennsylvania Law Review* 653.

³³ Id., p. 690.

³⁴ A. Dignam, 'The future of shareholder democracy in the shadow of the financial crisis' (2013) 36 *Seattle University Law Review* 639, at 688.

individual investors;³⁵ Andrew Keay too blames managerial short-termism which is seen as a consequence of shareholder pressure and the emphasis on quarterly earnings;³⁶ and Simon Deakin considered the reasons for excessive risk-taking, namely, the ‘increasing alignment of managerial interests with those of shareholders, through corporate governance innovations such as share options and independent boards’.³⁷

Newspaper articles have expressed similar views. According to a column in the *Observer*,³⁸ regardless of theory, ‘a system that encourages the same organisation to pay one person 470 times what another gets will eventually blow up’. But the column does not suggest that therefore incentives should be more closely aligned to shareholders. Rather, the opposite: this trend need to be reversed as the management’s first accountability should be to those who have the greatest power to create or destroy shareholder value – employees, customers and suppliers.³⁹

This relates to the general question of what is meant by corporate governance, in particular in the context of the recent financial crisis. We take the view that corporate governance needs to address ‘the basic legal characteristics of the business corporation.’⁴⁰ Yet, the tendency has been to concentrate entirely on the protection of shareholders. Corporate governance has been ‘increasingly perceived in a narrow sense, that is, pertaining solely to the internal and external control mechanisms between shareholders and managers.’⁴¹ This has led to the managers concentrating on the share/stock market price as a mechanism of aligning shareholders’ and managers’ interests in order to reduce agency costs. Inadvertently, this has given managers to adopt much risk-taking – and major parties in corporate governance have acquiesced into this trend.

It is however difficult to blame the cause of the financial crisis on corporate governance, even when perceived in its narrow sense. The causes seem to be of risk management, which is a question of judgement for directors, and not per se, a question of shareholders’ role in corporate governance. While in its 2009 report, the Organisation

³⁵ L.A. Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public* (2012). See also L.A. Stout, ‘New Thinking on “Shareholder Primacy”’ (2012) *Accounting, Economics, and Law*, vol. 2, iss. 2, article 4

³⁶ A. Keay, ‘Risk, shareholder pressure and short-termism in financial institutions: does enlightened shareholder value offer a panacea?’ (2011) 5 *Law and Financial Markets Review* 435.

³⁷ S. Deakin, ‘The Corporation as Commons: Rethinking Property Rights, Governance and Sustainability in the Business Enterprise’ (2012) 37 *Queen’s Law Journal* 339. See also S. Deakin, ‘Corporate governance and financial crisis in the long run’, in *The Embedded Firm*, Cynthia A. Williams and Peer Zumbansen eds. (2011), pp. 30-40.

³⁸ For the following see S. Caulkin, ‘It’s time to explode the myth of the shareholder’, *The Observer*, 9 March 2009, <<http://www.guardian.co.uk/business/2009/mar/29/corporate-governance-moneyinvestments>>. Similar W. Hutton, ‘We need a revolution in how our companies are owned and run’, *The Observer*, 29 September 2012, <<http://www.guardian.co.uk/commentisfree/2012/sep/30/will-hutton-new-model-capitalism>>.

³⁹ The ‘shareholder-stakeholder debate’ is also a frequent topic of the academic literature. See, e.g., A. Keay, *The Corporate Objective. Corporations, Globalisation and the Law* (2011); M. Siems, ‘The Ranking of Shareholder and Stakeholder Interests in Common and Civil Law Countries’, in *Company Law and CSR: New Legal and Economic Challenges*, Ivan Tchotourian ed. (2013), forthcoming.

⁴⁰ J. Armour et al., ‘What is Corporate Law?’, in R Kraakman et al. (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2nd edn., 2009) 1.

⁴¹ L. Horn, ‘Corporate Governance in Crisis? The Politics of EU Corporate Governance Regulation’ (2012) 18 *European Law Journal* 83, at 94.

for Economic Co-operation and Development (OECD) concluded that ‘the financial crisis can be to an important extent attributed to failures and weaknesses in corporate governance arrangements’,⁴² this conclusion also needs to be understood from the background of an Anglo-Saxon model of corporate governance that is predominantly shareholder oriented. This model concentrates on private aspects of corporate governance, which focuses on internal control mechanisms of aligning interests between shareholders and managers. It places public aspects of corporate governance at the periphery – such that ‘public intervention in corporate governance system is only tolerated where it serves to ease market failures.’⁴³ But it is difficult to see how far simply giving more powers to shareholders could have averted the financial crisis. Yet, this should not be seen as our final word since we also need to examine shareholder engagement in light of possible changes to investor cultures.

SHAREHOLDER ENGAGEMENT AND INVESTOR CULTURES

1. Short-term versus long-term investment

Before the 2008 financial crisis, investor culture had shifted from long term to short term orientation.⁴⁴ Subsequently, this has often been seen as a problem. For example, in the Green Paper on Corporate Governance the European Commission found ‘evidence that the majority of shareholders are passive and are often only focused on short-term profits’,⁴⁵ and a subsequent Green Paper specifically dealt with the aim of long-term financing of the European economy.⁴⁶ Thus, the problem is that corporate governance with its emphasis on shareholder value has enhanced investor pressure for greater returns on short-term investment, and that such short-term investors hardly engage with corporate governance for a greater sustainability.⁴⁷ For instance, in takeover situations, shareholders often have a short-term focus, as they may have purchased the shares after the bid has been announced in order to make a quick gain, should the takeover succeed, with no interest in the future of the company once they have accepted the offer and exit-

⁴² G. Kirkpatrick (ed.), *The Corporate Governance Lessons from the Financial Crisis* (Financial Market Trends, OECD 2009) 2.

⁴³ Horn, op. cit., n. 41, p. 86.

⁴⁴ For details see P.E. Masouros, *Corporate Law and Economic Stagnation: How Shareholder Value and Short-Termism Contribute to the Decline of the Western Economies* (2013) (identifying the breakdown of the Bretton Woods monetary order in the early 1970s as the main trigger).

⁴⁵ European Commission, op. cit., n. 15, p. 3.

⁴⁶ European Commission, Green Paper: Long-Term Financing of the European Economy, 25 March, 2013, COM(2013) 150 final. See also the 2010 consultation on a ‘Long-Term Focus for Corporate Britain’ by the Department for Business, Innovation and Skills, at <<https://www.gov.uk/government/consultations/a-long-term-focus-for-corporate-britain-a-call-for-evidence>>, which preceded the Kay Review (see op. cit., n. 19).

⁴⁷ This does not imply that long-term shareholders cannot also ‘benefit from managers destroying economic value’, J. M. Fried, ‘The Uneasy Case for Favoring Long-Term Shareholders’, ECGI - Law Working Paper No. 200 (2013), <<http://ssrn.com/abstract=2227080>>.

ed the company.⁴⁸ It also seems fair to assume that since the financial crisis this short-term investor culture has not changed: most shareholders of large public companies only hold their shares to maximise their financial return.⁴⁹

On the lack of shareholder engagement, the European Commission observed that ‘it is primarily long-term investors who have an interest in engagement.’⁵⁰ We believe the backdrop to this lack of shareholder engagement is the fact that investors who largely contribute to corporate liquidity tend to be short-term investors. Boards of financial firms striving to keep solvent and therefore in need of liquidity, pushed by stock market price index performance measures, are likely to have little choice but to focus on short-term demands of short-term liquidity providers. Long-term corporation growth is often left to non-financial institutions since ‘money growth’ and not corporation growth seems the trend in financial institutions.

In addition, the problem is more complex than merely lack of shareholder engagement. In its 2010 report, the OECD found that in both widely held companies and those with more concentrated ownership shareholders were ineffective in monitoring the boards, ‘neglecting the effect of excessive risk taking policies.’⁵¹ The problem can be traced from the gap between the capital provider and the corporation control, leading to a focus by shareholders on stock market price index to measure board performance. This led to shareholders acquiescing to the practice of short-termism by directors as they seek to meet the ostensible appetite of investors for higher and immediate returns. Should the law intervene to reverse this trend and foster a better monitoring and engagement shareholder culture?

On the need for better monitoring of corporate governance, the European Commission is of the view that regulatory authorities should not ‘interfere with the content of the information disclosed or make business judgements on the solution chosen by the company.’⁵² On the one hand, the law seems handicapped here. On the other hand, it should not seek to ensure no corporate failures. In other words, the law should not, and cannot, insist on success.⁵³ Indeed, the OECD observes ‘that effective risk management is not about eliminating risk-taking, which is a fundamental driving force in business and entrepreneurship’ but rather about ensuring ‘that risks are understood, managed and, when appropriate, communicated.’⁵⁴

⁴⁸ J. Payne, ‘Minority shareholder protection in takeovers: A UK perspective’ (2011) *European Company and Financial Law Review* 145, at 163.

⁴⁹ A.S. Ginevri ‘The rise of long-term minority shareholders’ rights in publicly held corporations and its effect on corporate governance’ (2011) 12 *European Business Organization Law Review* 587, at 602.

⁵⁰ European Commission, op. cit., n. 15, p. 11.

⁵¹ OECD, ‘Corporate Governance and the Financial Crisis: Conclusions and emerging good practices to enhance implementation of the principles’ (OECD, 2010) 24.

⁵² European Commission, op. cit., n. 15, p. 19.

⁵³ S. Worthington, ‘Shares and shareholders: property, power and entitlement (Part 1)’ (2001) 22 *Company Lawyer* 258, at 259.

⁵⁴ OECD, op. cit., n. 51, p. 13.

2. Dispersed shareholder structures in particular

For countries such as the UK and the US, the dispersion of shareholder ownership in most public companies⁵⁵ further makes it difficult for shareholders to engage in corporate governance. In dispersed ownership companies, say where each shareholder holds one per cent of the shares, shareholders tend to have little economic incentive to engage in corporate governance let alone seek to discipline directors. In such structures, shareholders do not have the time and the means to investigate directors' incompetence or excessive risk-taking. If the shareholders have shares in, say, 80 listed companies holding one per cent shares in each, they are only concerned with the share value on the stock market, and if the other company's shares are not doing well, they tend to simply sell the shares and invest somewhere else.⁵⁶

The disciplining of directors in dispersed ownership companies also tends to be left to the market forces – where the assumption is that competitiveness in the market would force management to converge on good and reasonable management, thereby increasing share value. The assumption here being that directors will very much avoid the lowering of share prices, as low share price on the market makes the company vulnerable to a hostile takeover bid, which, if successful, will usually result in the dismissal of the directors. The financial crisis has revealed weaknesses in these economic assumptions as managing to the stock market prices seems to have increased the appetite of excessive risk-taking.

Where, as a result of lack of shareholders' engagement, directors take excessive risks, causing loss to shareholders, English company law usually does not provide remedies. In fact, in the context of crises, company law may, especially takeover law, worsen the problem. Company law's response to such problem has often been to give an exit strategy to an aggrieved shareholder – a mechanism of selling shares at a fair price.⁵⁷ The most commonly applied relief for aggrieved shareholders is for the court to grant an order that 'the petitioners' shares be purchased by the controllers or the company', which 'gives the petitioner an opportunity to exit from the company with the fair value of his or her investment'.⁵⁸ This exit strategy is strengthened by takeover law;⁵⁹ yet, the exit strategy in takeovers neither increases shareholder engagement nor disciplines directors, for 'while takeovers might serve an industrial restructuring purpose, they serve no function in disciplining management'.⁶⁰

For years before the 2008 financial crisis, the markets have fostered an increase of short-term focused investors, as these have contributed to the much-needed liquidity.

⁵⁵ See generally F. Barca and M. Becht (eds.), *The Control of Corporate Europe* (2001).

⁵⁶ For empirical data on shareholder participation see P. Santella et al., 'Legal Obstacles to Institutional Investor Activism in the EU and in the US' (2012) 23 *European Business Law Review* 257, at 262-3.

⁵⁷ For example, a fair price following a successful petition under the unfair prejudice remedy, – formerly Section 210 CA 1948, then Section 459 CA 1985, and now Section 994 CA 2006; see *O'Neill v. Phillips* [1999] 1 W.L.R. 1092 for application of this remedy.

⁵⁸ Davies and Worthington, op. cit., n. 26, pp. 741-2. Such 'exit-strategies' are less common in civil law countries, see Siems, op. cit., n. 23, pp. 205-8.

⁵⁹ Part 28 Companies Act 2006.

⁶⁰ A. Johnson, 'The European takeover directive: ruined by protectionism or respecting diversity' (2004) 25 *Company Lawyer* 270, at 275.

The problem is when those who manage companies fail to know where to draw the line between attracting liquidity and placing business on a sustainable platform. But what choice do managers have if even the traditionally long-term institutional investors give their mandates through market pressure for greater short-term returns? In dispersed ownership companies, the problem is worse: short-term investors tend to ‘invest in thousands of companies, with small stakes in any individual company – it is impossible for any investor to truly understand all these investments.’⁶¹ Accordingly, the focus tends to be on short-term gains without engagement. We therefore observe the well-known problem that for such shareholders ‘exit’ is just too easily available in order to make any effort for ‘voice’⁶² a worthwhile endeavour.

3. Institutional shareholders and engagement

The lack of shareholder engagement is exacerbated by the fact that today institutional investors often outsource their investment decisions to external asset managers.⁶³ These asset managers tend to focus on short-term gains based on market price index, and are usually not interested in engagement with corporate governance. In the words of Jaap Winter, these asset managers, if ‘pushed by regulation and codes that require or expect such engagement they will at best engage at what I call a compliance level: engaging because and to the extent they have to.’⁶⁴ Should the answer be more regulation? Or should investor culture change? To pursue the former is to paternalistically seek to protect investors, yet the latter is difficult to pursue by legal intervention. Still, there is need for a paradigm shift in investor cultures. Whether this paradigm shift should come via legal regulation or via self-regulation by the markets is the question. According to Winter:

‘A key challenge of regulation, in general, but certainly in response to a crisis, is to distinguish which problems can be meaningfully addressed by new regulation and which problems cannot. A bigger challenge still is to act on this distinction and to have the courage not to regulate the latter problems but to seek different avenues of addressing them. Such avenues would typically involve challenging and exposing the world views, beliefs, myths and assumptions underlying the current ways of being and acting.’⁶⁵

Whether we seek new regulation to influence a paradigm shift, it seems that the EU financial law has often not been helpful in increasing shareholder engagement. Pension and insurance investments have to invest in accordance with the ‘prudent person’ rule, and this entail that assets being properly diversified in such a way as to avoid excessive

⁶¹ J. Winter, ‘The financial crisis: does good governance matter and how to achieve it?’ *DSF Policy Paper* 14/2011, p. 7.

⁶² This refers to A.O. Hirschman, *Exit, Voice, and Loyalty* (1970). See also Kay Review, op. cit., n. 19, para. 2.2.

⁶³ J. Winter, ‘Shareholder Engagement and Stewardship: The Realities and Illusions of Institutional Share Ownership’, Working Paper 2011, at p. 5, <<http://ssrn.com/abstract=1867564>>.

⁶⁴ Winter, op. cit., n. 61, p. 8.

⁶⁵ Winter, op. cit., n. 61, p. 14.

reliance on any particular undertakings and accumulations of risk in the portfolio as a whole.⁶⁶ Thus, the aim is to avert risk-taking by encouraging diversification. However, the result of diversification of portfolio is ‘an investment policy that is not focused on an actual understanding of individual companies, but on more or less following the market.’⁶⁷ This hardly encourages engagement.

The culture remains that most institutional shareholders are interested in returns on investment, which is monitored via the market-share price index, without the need of engagement in internal governance of the company. But for meaningful shareholder engagement, this will require a shift in the investment culture. In the light of the 2008 financial crisis, investors may need to take John Maynard Keynes seriously:

‘As time goes on I get more and more convinced that the right method in investment is to put fairly large sums into enterprises which one thinks one knows something about and in the management of which one thoroughly believes. It is a mistake to think that one limits one's risks by spreading too much between enterprises about which one knows little and has no reason for special confidence’.⁶⁸

Thus, there is need to revert to a culture that focuses on long-term sustainability of companies rather than short-term value gains. Lessons could be gained from the traditional German corporate governance model, which is sustained historically by a notion of long-term commitment between the company and its various stakeholders – with its tenets of not focusing on making money per se, but on product quality and innovation, by which it was able to evade price competition and sustain investment-high growth levels.⁶⁹ But this model does not exist in its pure form any more. Especially in the financial sector, a number of global factors have altered the traditional German corporate governance model, making companies more susceptible to hostile takeovers and norms such as shareholder value.⁷⁰

4. Sovereign Wealth Funds and shareholder activists

In addition we need to consider the changing composition of investors. Brenda Hannigan argues that ‘enthusiasm for shareholder engagement may be misplaced or at least may be based on unrealistic expectations’.⁷¹ The context of this caution relates well to the increasing Sovereign Wealth Funds (SWF) investors with declining domestic inves-

⁶⁶ Article 18 of Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision. Similar Article 132 of Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (‘Solvency II’).

⁶⁷ Winter, op. cit., n. 63, p. 6.

⁶⁸ John Maynard Keynes (1883-1946), British economist, Letter to F.C. Scott (15 August 1934), quoted in J. Runde and S. Mizuhara (eds.) *The Philosophy of Keynes's Economics: Probability, Uncertainty and Convention* (2003) 154.

⁶⁹ A. Digman and M. Galanis, *The Globalization of Corporate Governance* (2009) 301-2.

⁷⁰ Id., pp. 391-2.

⁷¹ B. Hannigan, ‘Board failures in the financial crisis: tinkering with codes and the need for wider corporate governance reforms: Part 2’ (2012) *Company Lawyer* 35, at 36.

tors. A 2012 survey shows a decline of domestic investor shareholding with an increase of foreign investment between 1981 and 2012.⁷² Insurance funds holdings declined from 20.5% to 6.2% and pension funds from 26.7% to 4.7%, with foreign holdings at 53.2% in 2012.⁷³ SWF investments are usually treated with high levels of mistrust and suspicion, especially if these SWF are from governmental regimes and legal systems not leant on democratic principles or not assuming market fundamental liberties.⁷⁴ Most of these SWFs are from emerging economies. The call for measures that would avoid potential negative consequences of investments by SWFs is heard louder and louder in the West.⁷⁵ Hannigan observes that encouraging engagement by those types of investors is more challenging, not least because they are less susceptible to domestic political pressures to engage.⁷⁶

Beyond SWFs, there has been a growing literature on the possible detrimental effects of activist shareholders. Critics have said that the real problem is now that ‘meddling and second-guessing from shareholders’ makes it hard for managers to do their jobs effectively.⁷⁷ There may therefore be the need to ‘protect the autonomy of management’ in corporate governance.⁷⁸ Yet, one should also not exaggerate the risks of shareholder activism. Following Iris Chiu,⁷⁹ it seems plausible to distinguish: while there is no denying that some activist hedge funds may harm companies, other activist shareholders may have a more positive effect. Thus, for example, it is an open question of whether activist shareholders should owe fiduciary duties to the company, as we would need more empirical evidence about the costs and benefits of such shareholder activism.

5. Where do we go from here?

In this section we have seen that the question of shareholder engagement and investor culture remains a challenge. In the UK, where shareholding in listed companies is mostly dispersed, the market does not encourage shareholder engagement in corporate governance. The structure and regulation of equity markets today overwhelmingly emphasise ‘exit’ over ‘voice’ and this has often led to shareholder engagement of superficial

⁷² Office of National Statistics, *Ownership of UK Quoted Shares, 2012* (London, September 2013).

⁷³ Note though, the survey does not mention the percentage of Sovereign Wealth Funds accounted in the 53.2% foreign shareholdings.

⁷⁴ J.W.I. Jimenez and A.P. Urena, ‘Sovereign wealth fund (SWF) global regulation and transparency: a preliminary private-investment law approach’ (2010) 25 *Journal of International Banking Law and Regulation* 441, at 446.

⁷⁵ B. De Meester, ‘International Legal Aspects of Sovereign Wealth Funds: Reconciling International Economic Law and the Law of State Immunities with a New Role of the State’ (2009) 20 *European Business Law Review* 779, at 780.

⁷⁶ Hannigan, op. cit., n. 71, p. 37.

⁷⁷ J. Fox and J.W. Lorsch, ‘What Good Are Shareholders?’, (2012) 90 (Jul/Aug) *Harvard Business Review* 48, at 50.

⁷⁸ B. Segrestin and A. Hatchuel, ‘Beyond Agency Theory, a Post-crisis View of Corporate Law’ (2011) 22 *British Journal of Management* 484.

⁷⁹ I. H.-Y. Chiu, *The Foundations and Anatomy of Shareholder Activism* (2010). See also D. Katelouzou, ‘Myths and Realities of Hedge Fund Activism: Some Empirical Evidence’ (2013) 7 *Virginia Law & Business Review* 459 (empirical study not finding activist hedge funds being excessively short-termist).

character and low quality. But even with more concentrated shareholdings and stronger employee participation, like in Germany, global factors have long changed investor culture making engagement difficult. Thus, the suggestion to shift towards more companies with family and employee ownership⁸⁰ is unlikely to be a solution to all problems of corporate governance.

Yet, more generally, the financial crisis of 2008 may initiate a paradigm shift away from a short-term investment culture towards effective long-term investment and shareholder engagement. Legal reforms can well play a supporting role. These reforms may increase the protection of shareholders – while it also needs to be considered that just giving shareholders more powers would be unsatisfactory since shareholders may also abuse such an enhanced governance role.

In detail, it is suggested that the following measures can be useful tools to encourage long-term value creation. First, legal rules can explicitly reward long-term shareholders. A possible model is the provision of the French Commercial Code on ‘loyalty dividends’, namely that the articles ‘may allot an increase in dividends, with a ceiling of 10%, to any shareholder who can show a registered contribution of at least two years’ duration’.⁸¹ The EU Green Paper on Long-Term Financing also considers such incentive structures.⁸²

Second, following a similar logic, the recent literature has suggested to modify the strength of voting rights according to the duration shares have been held,⁸³ or even to impose a minimum period in which shares cannot be sold.⁸⁴ The first of these suggestions could also be used to stimulate entrepreneurship, but this would be different for the second one: thus, it is also clear that encouraging long-term shareholder ownership is not and should not be the only aim that company law should pursue.

Third, beyond these direct tools, various other rules of company law play a role. For example, it is frequently suggested that remuneration structures should be designed as to reward long-term performance, say, by way of distributing shares to directors that they have to hold until retirement from their post.⁸⁵ Another prominent example is disclosure and transparency: here it is increasingly understood that a balance has to be found since, on the one hand, corporate disclosure fosters accountability, but, on the other, excessive reporting requirements foster short-termism.⁸⁶

⁸⁰ European Commission, op. cit., n. 16, p. 11. For the UK see The Ownership Commission, *Plurality, Stewardship and Engagement*, March 2012, <<http://ownershipcomm.org/>> and now the provision on ‘employee shareholders’ in Section 205A Employment Rights Act 1996, inserted by Growth and Infrastructure Act 2013, c. 27.

⁸¹ Code de Commerce, article L232-14, as translated at <<http://www.legifrance.gouv.fr/Traductions/en-English/Legifrance-translations>>.

⁸² European Commission, op. cit., n. 46, p. 15.

⁸³ C. Mayer, *Firm Commitment* (2013) 211-2. For previous suggestions by Lord Myners see Chiu, op. cit., n. 79, p. 164. More generally on the trend away from the ‘one-share one vote-principle’ W.-G. Ringe, ‘Deviations from Ownership-Control Proportionality – Economic Protectionism Revisited’, in *Company Law and Economic Protectionism: New Challenges to European Integration*, U. Bernitz and W.-G. Ringe eds. (2010), 219-40.

⁸⁴ Hockman, op. cit., n. 38. Apparently, this suggestion goes beyond ‘lock-up periods’, common for the time immediately after IPOs.

⁸⁵ BIS, op. cit., n. 19, p. 30.

⁸⁶ See, e.g., the debates preceding the 2013 revision of the EU Transparency Directive, available at

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The previous section concluded with a number of suggestions on how to improve corporate governance. But if these are only taken up in one country, the apparent risk is that international investments would just move elsewhere. Thus, the question is how and by whom those and other regulatory responses can or should be implemented.

Self-regulation in UK company law started in the early 1990s following a number of business scandals. Today corporate governance codes are common in many countries.⁸⁷ These codes usually follow the UK model of the Combined Code in requiring companies to give a statement showing how far they comply with the code ('comply or explain'). Their potential advantages are said to lie in their liberality, flexibility and effectiveness: if self-regulation works, there is no need to have recourse to the harsher and less flexible means of statute law. It may also be particularly effective regulation because corporate governance codes are usually developed by groups that have special professionalism and expert knowledge.⁸⁸

In the post-crisis world there are, however, also reasons to be cautious. Generally speaking, self-regulatory tools can be seen as a form of deregulation since companies are given more flexibility. Yet, a lesson to be drawn from the financial crisis is that just leaving everything to market forces may have devastating effects. More specifically, corporate governance codes are based on the idea that shareholders are able to properly assess whether and how companies comply with the codes. But, considering the crisis, this seems a bit naïve since shareholders did not stop excessive managerial risk-taking. Moreover, self-regulation can lead to one-sided rules since short-term interests may take preference over the interests of long-term shareholder as well as employees, consumers and the general public.

But it is also possible that self-regulation can specifically target the lack of responsible shareholder engagement. In the UK, the Walker Review observed that in the run-up to the financial crisis, board and director shortcomings would have been tackled more effectively had there been more vigorous scrutiny and engagement by major investors acting as owners.⁸⁹ This led to the Stewardship Code,⁹⁰ which – similar to the Combined Code – is voluntary but asset managers are required to report whether or not they apply the Code. One of its core principles is that institutional investors should monitor their investee companies. In the responses to the EU Green Paper on corporate governance some suggest that this model may be extended to the entire EU.⁹¹ Given the internationalisation of institutional investments, it seems logical to have a code that is not

<http://ec.europa.eu/internal_market/securities/transparency/>.

⁸⁷ See, e.g., <http://www.ecgi.org/codes/all_codes.php>.

⁸⁸ See the summary of the discussion in Siems, *op. cit.*, n. 23, pp. 387-90.

⁸⁹ The Walker Review, 'A review of corporate governance in UK banks and other financial industry entities – Final recommendations' (Financial Reporting Council, November 2009) para 5.11.

⁹⁰ Revised in 2012, <<http://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx>>.

⁹¹ See European Commission, Feedback Statement – Summary of Responses to The Commission Green Paper on The EU Corporate Governance Framework, Brussels, 15 November 2011, D(2011), p 12. European Commission, *op. cit.*, n. 16, p. 8 also refers to the UK Stewardship Code.

limited to a particular country. Yet, it may also be worth waiting for empirical evidence showing whether the Stewardship Code has a positive effect in practice, not only for investors but also in terms of public accountability.⁹²

The general question whether we need more European harmonisation in shareholder law has to start with an assessment of the status quo. The Shareholder Rights Directive⁹³ has only harmonised some aspects of the law, and even there Member States have retained a significant degree of discretion. Other elements of EU company law only indirectly relate to shareholder protection, for instance, if one assumes that rules on capital maintenance⁹⁴ may not only serve the interests of creditors but also minority shareholders. More extensive harmonisation can be found in EU securities regulation, for instance, on prospectuses, transparency, market abuse and investment services.⁹⁵ But, these rules are not specifically aimed at the protection of shareholders, since they typically also protect other investors, such as bondholders, or deal with the functioning of financial markets more generally.⁹⁶

Should the EU get more closely involved in the harmonisation of core company law, for instance, provide uniform rights to minority shareholders throughout the EU?⁹⁷ In general, uniform laws have a number of benefits, such as creating a 'level playing field', reducing transaction costs and providing legal certainty for cross-border businesses.⁹⁸ However, it can also be questioned whether such harmonisation is necessary – or even useful. As one of us has shown, in company law legal systems come closer together even without formal harmonisation;⁹⁹ and as far as such convergence has its limits, these can actually be seen as advantageous, for instance, enabling some experimentation and accommodating different shareholder ownership structures.¹⁰⁰

⁹² See I. H.-Y. Chiu, 'Stewardship as a Force for Governance: Critically Assessing the Aspirations and Weaknesses of the UK Stewardship Code' (2012) 9 *European Company Law* 5 (suggesting that these latter aspects should also be considered). On the practical application of the code see also Institute of Chartered Secretaries and Administrators, 'Enhancing Stewardship Dialogue', March 2013, <https://www.icsaglobal.com/assets/files/pdfs/guidance/Enhancing_stewardship_dialogue/icsastewardshipreport.pdf>.

⁹³ Op. cit., n. 5.

⁹⁴ Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 54 of the Treaty on the Functioning of the European Union, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent.

⁹⁵ References at <http://ec.europa.eu/internal_market/securities/index_en.htm>.

⁹⁶ An exception is Transparency Directive 2004/109/EC, op. cit., n. 5, art 17 (on exercising shareholder rights by proxy and information provided to shareholders in the run-up to the general meeting).

⁹⁷ See European Commission, op. cit., n. 15, p. 17.

⁹⁸ See the summary in Siems, op. cit., n. 23, pp. 373-4. In particular, this may be needed for cross-border voting rights: see European Company Law Experts, 'Response to the European Commission's Consultation on The Future of European Company Law', May 2012, pp. 9-10, <<http://ssrn.com/abstract=2075034>>.

⁹⁹ Siems, op. cit., n. 23.

¹⁰⁰ See also M. Siems, 'The Case Against Harmonisation of Shareholder Rights' (2005) 6 *European Business Organization Law Review* 539.

But when we turn to more specific measures, the assessment may be more positive. The EU Green Paper asks whether the EU should facilitate shareholder cooperation, for instance, by way of web based platforms and networks.¹⁰¹ This is directly relevant in the current context. In the previous sections we explained that shareholders are often not interested in the long term development of their company since they feel that their individual votes would not make a difference. Thus, measures that can address this collective action problem would be useful, though they may not necessarily require formal EU legislation.

Another lesson from the crisis is that relying on national or regional responses is not sufficient. As stated by the European Commission: ‘the crisis is global and calls for an international response’.¹⁰² To start with, this requires taking stock of the extent to which topics of shareholder protection and corporate governance have been addressed at the international level. The main source are the OECD Principles of Corporate Governance which provide, for instance, minimum standards on shareholder rights and equal treatment of shareholders.¹⁰³ Yet, these are drafted in very general terms; thus, the OECD Principles mainly confirm what most developed countries of the world already provide in their company laws.¹⁰⁴ Moreover, the OECD Principles are not formally binding. The same is the case for other international documents related to corporate governance, such as the OECD Guidelines for Multinational Enterprises¹⁰⁵ and the various recommendations by the International Organization of Securities Commissions (IOSCO).¹⁰⁶

Despite the crisis, it cannot be expected that the international community will be able to agree on a common approach to shareholder protection. Yet, a number of current initiatives aim to provide improved forms of regulation and supervision of international financial institutions and markets.¹⁰⁷ Concerns of financial stability have been on the agenda of the recent summits of the G20 in London, Pittsburgh, Toronto and Seoul. For example, at the London summit it was agreed to establish a Financial Stability Board (FSB) in order to monitor the global financial system. With respect to financial institutions, reference needs to be made to the ‘Basel III’ framework of the Basel Committee on Banking Supervision: this will increase capital adequacy requirements of banks; in addition, the Basel Committee has adopted Principles for Enhancing Corporate Governance, for instance, specifying obligations for risk management and internal control.¹⁰⁸

¹⁰¹ See European Commission, op. cit., n. 91, p. 14. See also the innovative proposal by E. Micheler, ‘Facilitating Investor Engagement and Stewardship’ (2013) 14 *European Business Organization Law Review* 29.

¹⁰² European Commission, ‘Restoring the Health and Stability of the EU Financial Sector’, 2012, p 6, available at <http://ec.europa.eu/internal_market/smact/docs/20120206_restoring_health_en.pdf>.

¹⁰³ Available at <<http://www.oecd.org/dataoecd/32/18/31557724.pdf>>.

¹⁰⁴ But see also M. Siems and O. Alvarez-Macotella, ‘The OECD Principles of Corporate Governance in Emerging Markets: A Successful Example of Networked Governance?’, in *Networked Governance, Transnational Business and the Law*, Mark Fenwick et al. eds. (2014), forthcoming.

¹⁰⁵ Available at <<http://www.oecd.org/dataoecd/43/29/48004323.pdf>>.

¹⁰⁶ See <<http://www.iosco.org/>>.

¹⁰⁷ See, e.g., the discussion in C.R. Kelly and C. Sungjoon, ‘Promises and Perils of New Global Governance: A Case of the G20’ (2012) 12 *Chicago Journal of International Law* 491.

¹⁰⁸ Principles for Enhancing Corporate Governance, October 2010, <<http://www.bis.org/publ/bcbs176.htm>>.

These initiatives show that, as far as corporate governance is concerned, it is specifically the financial sector that may need to be addressed. As Jaap Winter explains, the corporate culture of this sector is precisely what contributed to the crisis:

‘A corporate culture of aggressive pursuit of profits with a win-at-all-cost mentality is prone to higher risk-taking and to being arrogant about the risks that are being run. The financial industry seems to have been captured by this culture more than any other business sector, fuelled by substantial and in a number of cases excessive personal gains that could be made by the key players in the industry.’¹⁰⁹

This line of reasoning is also reflected in statements of the EU Green Paper on corporate governance,¹¹⁰ which builds on another Green Paper which explicitly dealt with the corporate governance in financial institutions.¹¹¹ In the ‘Basel’ and EU documents on the corporate governance of financial institutions the core emphasis is not on strengthening shareholder rights. Thus, as is the position in this paper, while shareholders play a role, increasing shareholder protection is not seen as a panacea to prevent another crisis.

CONCLUSION

The global financial crisis that started in 2008 has stimulated the debate on corporate governance and shareholder protection. This paper critically examined the discussion about the financial crisis, shareholder protection and law reform. We started with the question of *what* has caused the financial crisis, the answer being that it is not clear that corporate governance was one of the key determinants. This was followed by the question of *whether* post-crisis shareholder empowerment should be on the agenda; again, we could only give a cautiously positive reply. Then, we analysed *how* investor cultures shape the engagement of shareholders. Drawing lessons from the crisis, we took the view that one should encourage shareholder engagement by responsible long-term investors, and we provided specific examples on how this may be achieved. Finally, we discussed *who* should implement such a position. We gave the pragmatic response that a mix of self-regulation, national legislation and EU and international hard and soft law may be a feasible way forward.

Thus, to address the question posed in the title of this paper, simply telling the EU to improve shareholder protection would not be a satisfactory response. First, EU legislation is not necessarily the best tool: changing investor cultures is not primarily a legal question; self-regulation may play some role; and international initiatives may be more relevant than a regional response. Second, we do not take the view that any increase in shareholder rights is the way forward. The lesson learned is that the law should encourage shareholder engagement by responsible long-term investors, thus avoid excessive risk-taking and short-termism.

¹⁰⁹ Winter, op. cit., n. 61, p. 5.

¹¹⁰ E.g., European Commission, op. cit., n. 15, pp. 3, 10-11 (calling financial institutions ‘a special case’).

¹¹¹ European Commission, Green Paper on Corporate Governance in Financial Institutions and Remuneration Policies, COM(2010) 284.

The EU Green Paper indicated that ‘taking into account the diversity of situations, it does not seem possible to propose a “one size fits all” risk management model for all types of companies’.¹¹² This is a statement we also endorse. Since the behaviour of financial institutions lies at the heart of the financial crisis, their corporate governance has to receive special attention, for instance, requiring an enhanced involvement of shareholders, financial supervisors and external auditors.¹¹³ In particular, in regard to financial institutions, where taxpayers may be called upon to bailout financial institution and for avoidance of systemic failures, robust regulatory approach may be justified. Thus, while these details of bank governance and bail-outs go beyond the scope of the current paper, they confirm our position that there are no easy answers on how we can prevent a repeat of recent events.

¹¹² European Commission, op. cit., n. 15, p. 10.

¹¹³ European Commission, op. cit., n. 111. Specifically on shareholder rights/power see, e.g., K. Alexander, ‘Balancing prudential regulation and shareholder rights’ (2009) 1 *Journal of Corporate Law Studies* 61; V. Babis, ‘The impact of bank crisis prevention, recovery and resolution on shareholder rights’ (2012) 6 *Law and Financial Markets Review* 387; Daniel Ferreira et al. ‘Shareholder Empowerment and Bank Bailouts’, ECGI – Finance Working Paper No. 345/2013, <<http://ssrn.com/abstract=2170392>>.